# TESTIMONY OF
# REPRESENTATIVE MARK S. KIRK (IL-10)
# BEFORE THE U.S HOUSE OF REPRESENTATIVES
# COMMITTEE ON GOVERNMENT REFORM
# SUBCOMMITEE ON REGULATORY AFFAIRS
# APRIL 5, 2006

Chairwoman Miller and Ranking Member Lynch, in 2002, Congress passed legislation having the greatest regulatory impact on securities markets since the Securities Exchange Act of 1934 – the Sarbanes-Oxley Act, or SOX. When a law makes sweeping changes to the way public companies interact with their accountants, investment bankers, and shareholders, we must undertake interim reviews of its impact, and be prepared to initiate changes if this law has "unexpected" or "unintended" consequences. I commend you for acting as a catalyst to this process.

Since last summer, Congressman Feeney, Congressman Meeks and I have participated in bipartisan "listening sessions," with the intent of hearing from all stakeholders how SOX is working well, and what needs to be changed. We have been told that the law has brought benefits to investors, in the form of improved financial reporting and better transparency, leading to a better investor understanding of financial risks. On the other hand, smaller companies question that the time and money they direct to SOX Section 404 compliance instead of productive business activities gives the greatest value to their shareholders. This cost/benefit analysis has many variables, which are currently being evaluated by the SEC, the GAO, and now by Congress. The Smaller Public Company Advisory Committee formed by the SEC will be releasing its 140-page report later this month. The recommendations of this Committee should be given careful consideration.

For my testimony, I would like to submit the following PowerPoint presentation, which summarizes what we have heard during these last eight months of listening and fact-finding. I invite you to join us in future listening sessions. I can assure you that companies and investors are anxious to make their views known to Congress.

# The Sarbanes-Oxley Act (SOX)

## Assessing the Impact of Unintended Consequences

# SOX Cost & Benefit

- SOX filled a public market need for greater accounting disclosure and independent assessment of a company's financial condition, bolstering investor confidence and stock market buoyancy eroded by the Enron and WorldCom scandals

- For large public companies, the direct cost of SOX compliance has been balanced by the benefit to investors who value transparency and greater financial disclosure; however, the burden of excess regulatory oversight has not been adequately measured

- For smaller public companies, the cost/benefit balance must still be evaluated

**William McDonough, former PCAOB Chairman :**

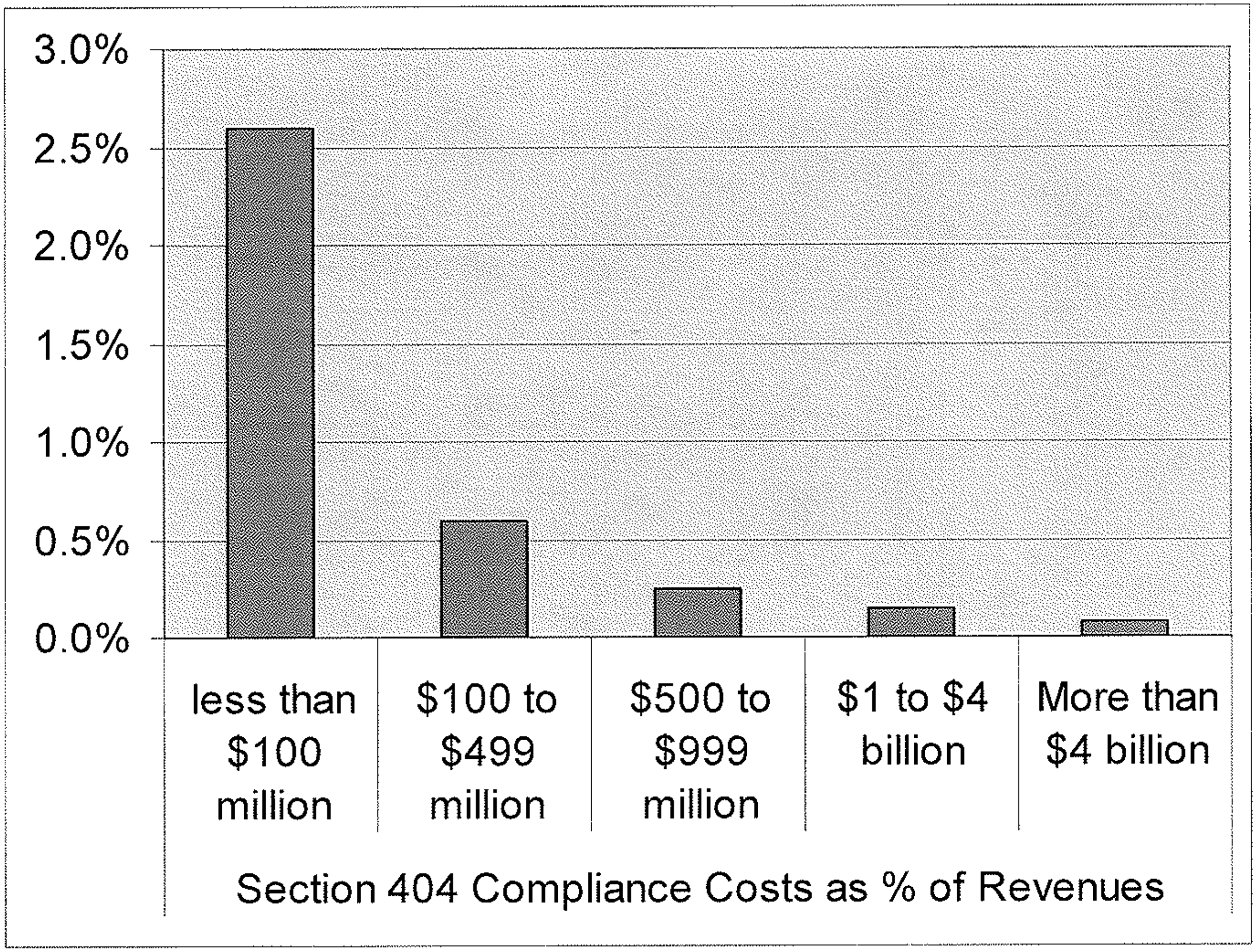
"*... it is inappropriate for the well-being of the American people if companies have costs which simply don't have any appropriate offsetting benefit.*" (Wall Street Journal, Oct. 2005)

**SOX has direct and indirect costs that must be evaluated:**

- **Profitability: SOX compliance is costing about 50 times more than estimated in 2002 and will exceed $6 billion in 2006 (AMR Research); as a percentage of revenue, smaller public companies bear a high cost with material bottom line impact**

- **Global Market Position: "Over the past few years, as more global investors have begun to invest in Asia, the New York Stock Exchange appears to have lost its allure for the region's leading companies.... The roots of New York's recent difficulties in winning Asian companies' listing lies in the high burden of regulations and compliance." (Financial Times, Nov. 2005)**

- **Global Corporate Competitiveness: SOX may be diverting and/or discouraging R&D expenditures (Cohen, University of Southern California)**




Sources: Corporate Insight and The Economist

**By extending the date of small company 404 compliance a year, the SEC has acknowledged a potential cost/benefit imbalance**

# Going Private ...

"As a private company, Vermont Teddy Bear will no longer face the challenges of a company trying to comply with increasingly complex and costly public company requirements," – Elisabeth B. Robert, the company's chief executive

| Company | Public Equity Moved to Private Investors | Date of Private Placement |
|---|---|---|
| Brookstone | $452 million | 10/4/2005 |
| Vermont Teddy Bear | $44 million | 9/30/2005 |
| SunGard Data Systems | $12.6 billion | 8/11/2005 |
| Toys R Us | $8.4 billion | 7/21/2005 |
| AMC Entertainment | $2.4 billion | 12/23/2004 |
| Loehmann's | $187 million | 10/13/2004 |

**In a survey of 147 public companies, Foley & Lardner found that 20% of respondents were considering going private – *up from 13% in 2003***

# … Or Reluctant to Go Public

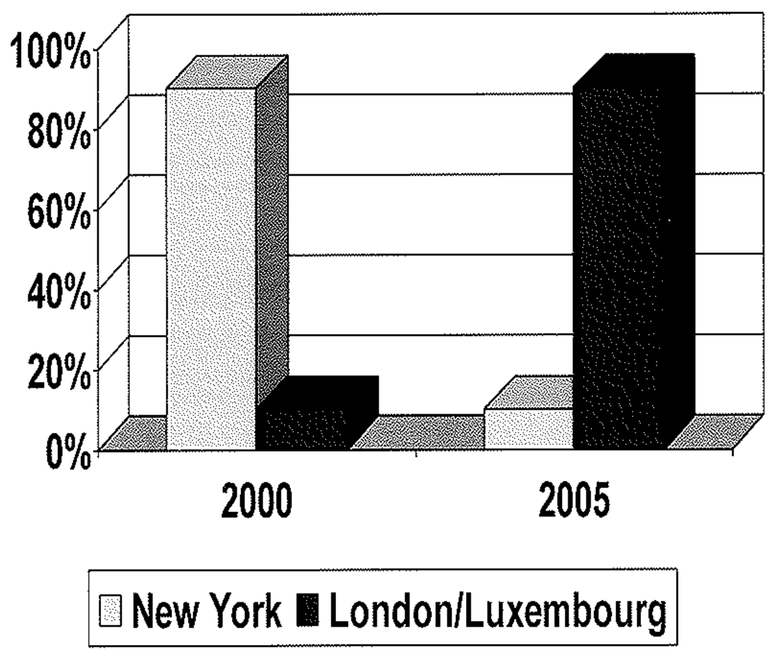
- "Because public companies need to comply with Sarbanes-Oxley …. (they) will face higher audit costs, higher insurance costs, and more regulatory-related duties for its staffers." – Inc. Magazine, *"What Does Sarbanes-Oxley Mean for Companies That Want to Go Public?,"* September 2005

- "But SOX has also had unintended consequences that generate complaints from small and mid-sized capitalization companies who say that their access to capital from publicly-traded stock markets has been made prohibitively expensive." – The Wall Street Journal op-ed by Bob Dole and Tom Daschle, *"Let's Reform the Reforms,"* October 2005

# ... Or Listing on Foreign Markets

**As documented by The Wall Street Journal's December 2005 article, *"New York Loses Edge in Snagging Foreign Listings,"* Citigroup data shows U.S. stock market dominance slipping**

New Stock Offerings ($) --
Non-US Companies




**In 2005, 23 out of the 25 largest Initial Public Offerings of stock (IPOs) chose not to register in the U.S. *Not one* of the top ten 2005 IPOs registered in the U.S.**

# Three Possible Reforms

- Small Business Relief – Exempt smaller public companies – the bottom 6% of public markets – from cost-prohibitive 404 reporting requirements, instead following financial statement rules applied to small business issuers

- Permit Compliance Consultants to Speak with Auditors – Modify the "independence rule" to allow prudent interaction between external auditors and internal consultants

- Return to Accepted Accounting Definitions of what is a large problem – Change the "material risk" standard for noting 404 weaknesses to a 5% *de minimus* criteria